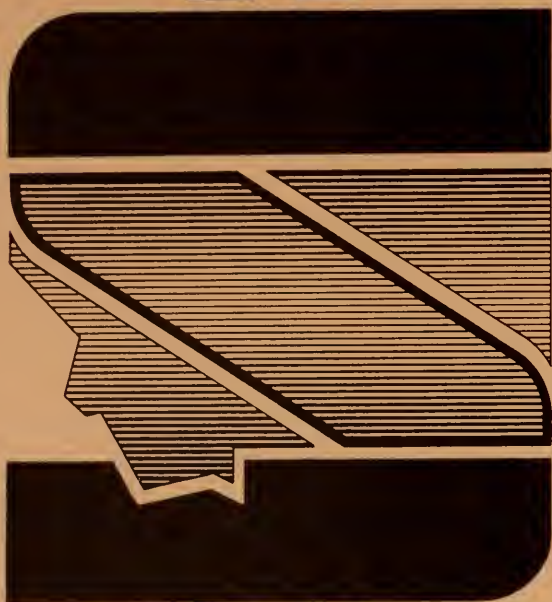


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**STATE OF MONTANA BOARD OF INVESTMENTS
1984-1985 Fiscal Year Report**

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STATE OF MONTANA BOARD OF INVESTMENTS

Department of Administration
The Honorable Ted Schwinden, Governor

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Business Executive
Helena

Gary Buchanan
Investments
Billings

Patrick McKelvey
Business Executive
Helena

W. E. Schreiber
Banker, Attorney
Whitefish

Wilbur Scott
Farmer
Great Falls

J. William Kearns, Jr.
Banker
Townsend

Frederick B. Tossberg
County Commissioner
Hamilton

INVESTMENT STAFF

James R. Howeth
Investment Officer

James R. Penner
Assistant Investment Officer

Richard A. Kain, CPA
Portfolio Manager

Robert T. Bugni
Portfolio Manager

Fred J. Godbout
Portfolio Manager

Edward J. Kelly
Portfolio Manager

Richard G. Cooley
Financial Analyst

Stephen R. Kenison
Financial Analyst

Leanne M. Cress
Accounting Supervisor

Mary Jane Mook
Senior Accountant

Lynne D. Hamilton
Accounting Technician

Dolores M. Parker
Accounting Technician

Michelle M. Wheat
Administrative Secretary

Rosemary Enloe
Accounting Clerk

Vivyan L. Gray
Administrative Clerk

Donna Wiseman Miller
Accounting Clerk

INTRODUCTION

The Montana State Board of Investments is honored to submit its Annual Report for the fiscal year ended June 30, 1985. The purpose of this report is to disclose investment performance for fiscal year 1985. Individual year-end portfolios are shown under separate cover titled "Supplement—State of Montana Board of Investments 1984-1985 Fiscal Year Report—Portfolios."

The uniform investment program established by Article VIII, Section A of the 1972 Montana Constitution directed that the Board of Investments have sole authority to invest State funds in accordance with the laws and Constitution of the State of Montana. The Board is to employ that degree of judgment and care which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, the so-called "Prudent Person" Rule. Permissible investments include bonds, notes, debentures, equipment obligations, common stock, commercial paper, bankers acceptances, interest bearing deposits in Montana financial institutions, real estate, and any other investment in a Montana business that continues existing jobs or creates new jobs. Common stock purchases are restricted to pension funds only. These investments are subject to statutory restrictions for quality and size of holding.

The Montana State Board of Investments consists of seven voting members appointed by the Governor, including five members who are informed and experienced in the subject of investments and one member each representing the Public Employees Retirement Board and the Teachers Retirement Board. The Board meets monthly to review portfolio and performance reports and approve investment activity.

The Board of Investments staff consists of an Investment Officer, an Assistant Investment Officer, six Portfolio Managers and Financial Analysts, seven Accounting personnel, and a Secretary. The staff seeks the optimum possible investment performance within the investment guidelines outlined in State statutes and consistent with the investment objectives of the various funds it manages. Total assets managed at June 30, 1985 exceeded 1.98 billion dollars.



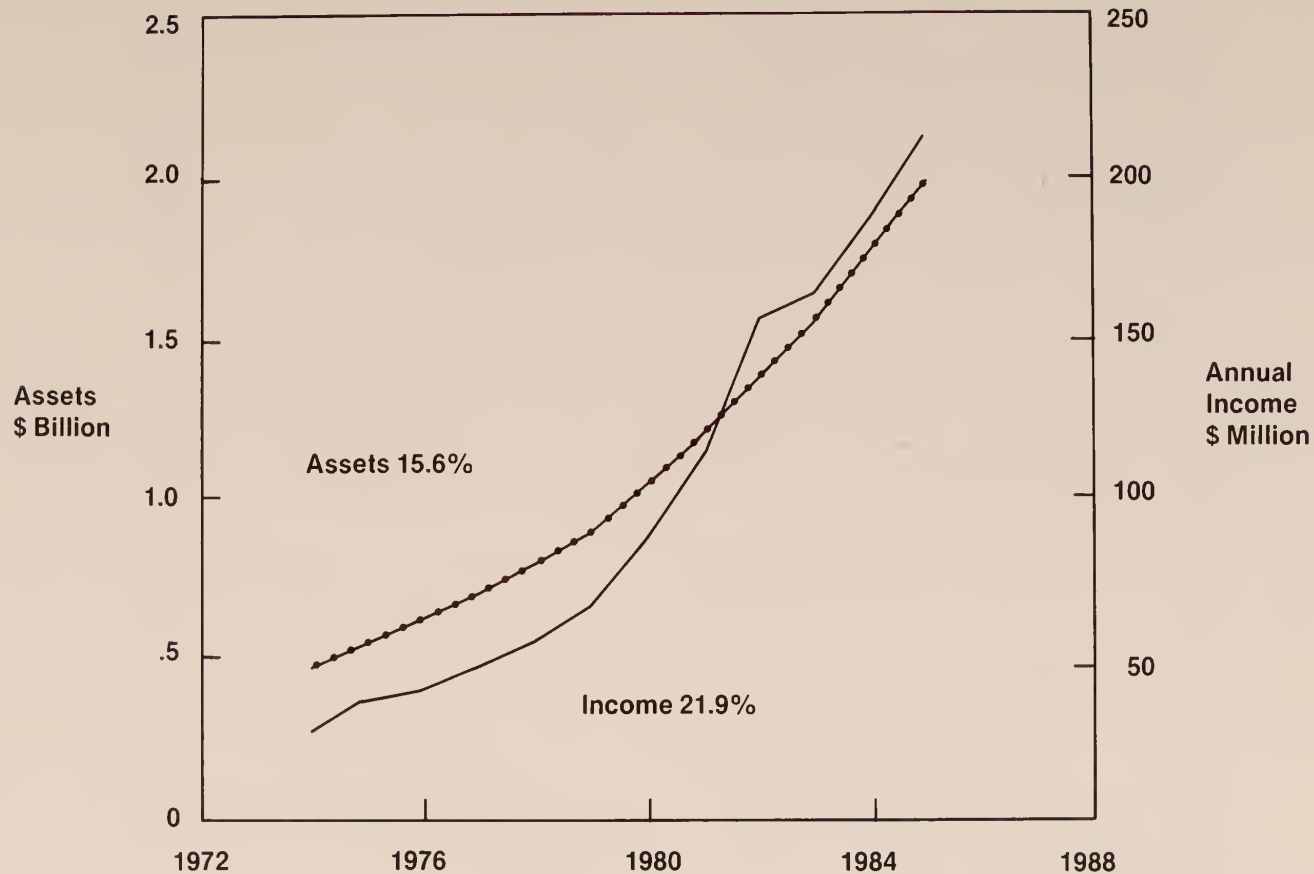
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CONTENTS

Assets & Income	1
Investment Review	2
Source of Investments	8
Flow of Funds	9
Summary of Security Transactions	10
Type of Investments	11
Total Investment Income	12
Treasurer's Fund	13
Short-Term Investment Pool	14
Public Employees' Retirement System Fund	15
Teachers' Retirement System Fund	16
Trust and Legacy Fund	17
Permanent Coal Trust Fund	18
Workers' Compensation Fund	19
Educational Trust Fund	20
Performance Comparisons	21
FINANCIAL STATEMENTS—Short-Term Investment Pool	
Auditor's Report	24
Statement of Investments Managed	25
Statement of Changes in Investments Managed	25
Statement of Investment Income and Distributions	26
Notes to Financial Statements	27
FINANCIAL STATEMENTS—Montana Common Stock Pool	
Auditor's Report	28
Statement of Investments Managed	29
Statement of Changes in Investments Managed	29
Statement of Investment Income and Distributions	30
Notes to Financial Statements	31
FINANCIAL SCHEDULES—All Other Funds	
Auditor's Report	32
Schedule of Investments Managed	33
Schedule of Investment Income	33
Schedule of Changes in Investments Managed	34
Notes to Financial Schedules	35
FINANCIAL STATEMENTS—Short-Term Investment Pool II	
Auditor's Report	37
Statement of Investments Managed	38
Statement of Changes in Investments Managed	38
Statement of Investment Income and Distributions	39
Notes to Financial Statements	40
Schedule A Source of Investments	41
Schedule B Investment Income 1984-85 Fiscal Year	42
Schedule C Summary of Bond Swaps	44
Schedule D Type of Investments	44
Schedule E Unamortized Deferred Gains or (Losses) on Bond Swaps	44
General Footnotes	45
Investment Income Yield Summary	45

ASSETS & INCOME



Assets at book value grew 11.1% to \$1.98 billion at yearend and will exceed \$2 billion early in Fiscal 1986. Total investment income for the year ending June 30, 1985 reached \$212.7 million, a gain of 14.1% from the previous year. The Board has earned in excess of \$1.2 billion of income since it began investing 14 years ago. The chart above illustrates the ten year compounded annual growth rate of investment income and total assets.

The asset mix at June 30, 1985 was 88% fixed income including short term securities, 8% Montana commitments, and 4% common stock. A performance summary for each major asset type is provided in the following pages along with various graphs, schedules, and audit reports which represent the Board's activity for Fiscal 1985.

INVESTMENT REVIEW

Fixed Income—Montana's bond portfolios compiled a total return of 40.6% for Fiscal 1985, which compares favorably to the 31.4% return earned by the Shearson Lehman Brothers Index, but fell slightly short of the 41.9% return earned by the Salomon Brothers Index. Declining interest rates pushed bond prices significantly higher producing exceptional total rates of return for portfolios heavily weighted with longer term bonds. Except for the 1981-83 rally, total returns for the 12 months ending June 30, 1985 were probably the highest for any comparable period in the postwar era. As in the previous cyclical rally, long term securities substantially outperformed those of medium maturities.

Performance Comparisons*

Fixed Income	Annual Return 1977-85	Fiscal Year 1985
Montana Bond Portfolios	10.4%	40.6%
Salomon Brothers Index	8.8%	41.9%
Shearson/Lehman Index	9.8%	31.4%
S.E.I. Median	NA	28.1%

The S.E.I. Median registered a smaller time weighted total rate of return because it includes funds that are short-term oriented and thus incur less price appreciation. The ongoing bond swapping program executed trades totaling \$188.2 million, enhancing the weighted net yields to maturity by 19 basis points (100 basis points equal 1%).

The primary determinants of lower interest rates during Fiscal 1985 were an accommodative Federal Reserve monetary policy and continued modest inflation. The Federal Reserve exhibited the willingness and ability to forestall recession through monetary ease. Low inflation gave the Fed an opportunity to adjust policy in response to changes in economic growth. Averting a recession was the top priority and overly rapid growth of the money supply became a peripheral consideration to be tolerated as long as inflation remained moderate.

DIRECT MONTANA INVESTMENTS

The Board of Investments has six programs for direct investment in Montana. These programs are carried out through participating financial institutions across the State. Currently, ninety-six institutions are participating. Total new monies invested in these programs was \$89.5 million during the year.

Montana Mortgages

There are four programs that purchase Montana Mortgages: The Conventional Residential Loan Program, FHA/VA Loan Program, Multi-Family Loan Program, and the Commercial Loan Program.

The Board serves as a secondary market to financial institutions (seller/servicers) throughout the State. Net yields are set using Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) quotes, the two major secondary market makers. Mortgage offerings are submitted on a participation basis or sold wholly to the Board. Mortgages in these programs are secured by single-family residential, multi-family residential, and commercial properties located in Montana.

During the year, \$37.6 million of mortgage commitments were issued to seller/servicers. Over 87% of the loans offered under commitments were purchased by the Board, totaling a record \$33.3 million this year, a 27% increase over the previous year's record volume. As of June 30, 1985, commitments issued and outstanding totaled \$14.3 million. Most of these commitments will be offered to the Board early in the current fiscal year providing impetus for continued high volume at least into midyear.

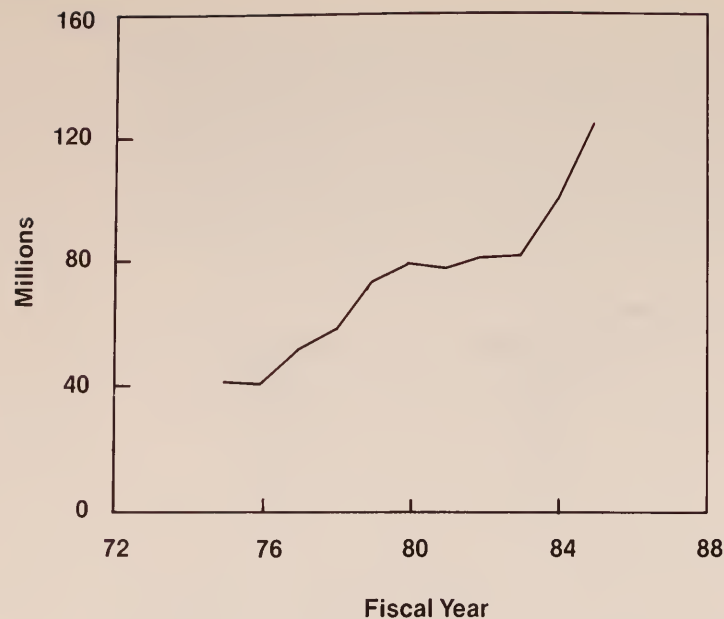
The graphs on the facing page illustrate purchases and year-end invested mortgage balances. The invested balance is the net of purchases and payoffs. Purchases are directly correlated with interest rates on mortgages; as interest rates increase less loans are made and offered to the Board. Higher interest rates caused the volume of purchases to decline from 1980 to 1981. Since 1981, volume has expanded each year by purchasing from a larger number of financial institutions and because of lower mortgage interest rates. Even with reductions and payoffs of nearly \$25.3 million over the last three years, the mortgage portfolio has managed to increase to \$124.7 million.

Small Business Administration (SBA) Loan Program

This program involves purchasing the guaranteed portion of SBA loans from Montana financial institutions. The seller/servicer is required to retain the unguaranteed portion and service the entire loan. The Board purchased both SBA loans offered in 1985, totaling \$312,700. The secondary market for the guaranteed portion of these loans is well established. This means the financial institutions in Montana shop around for the best possible rate. Since most of the loans are sold outside of Montana, much needed capital is brought into the state complimenting this program.

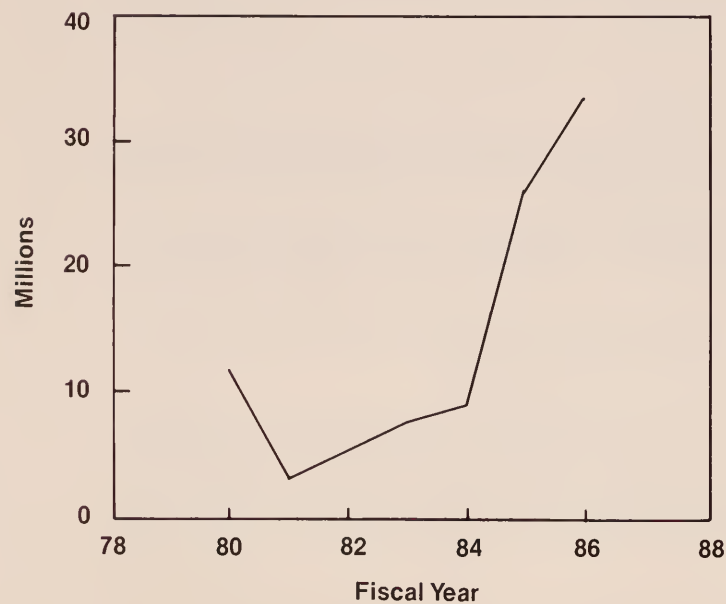
Certificates of Deposit

Financial institutions issued certificates of deposit to the Board after satisfying pledging requirements. The interest rates on these deposits are competitive with national rates for money market instruments. Purchases of certificates of deposit by the Board totaled \$56.2 million during the year with an outstanding balance of \$28.3 million at year end.



MONTANA MORTGAGES: INVESTED BALANCE

Including S.B.A. Loans



MONTANA MORTGAGES: PURCHASES

Including S.B.A. Loans

Common Stocks—Montana’s equity portfolio (Montcomp) achieved a S.E.I. first quartile ranking for the year with a healthy 35% advance on a time weighted total rate of return basis. This compares favorable with the 31% and 24% gains registered by the S&P 500 and Dow Jones Industrial Average, respectively. This marks the second consecutive year that Montcomp’s relative performance has attained the S.E.I. first quartile. The stock market, paced by transportation and utility issues, had an excellent year as lower interest rates, and reduced prices for oil translated into renewed optimism, if not exuberance, about prospects for continued economic growth. The Board’s objective is to increase emphasis on common stock purchases to bring holdings closer to national trends for pension fund portfolios.

Performance Comparisons*

<u>Equities</u>	<u>Annual Return</u> <u>1977-85</u>	<u>Fiscal Year</u> <u>1985</u>
Montana Common Stock	13.7%	35.1%
S&P 500	12.5%	31.1%
Dow Jones Industrial Average	9.1%	24.0%
S.E.I. Median	NA	30.3%

* The annualized time-weighted total rate of return is the standard formula used to measure relative performance. Income yield plus the gain or minus the decline in market value (often unrealized), adjusted for cash flow timing, produces the total rate of return results. The Board publishes the “Supplement” which lists individual assets by fund with market values indicated. The “Supplement” should be reviewed along with this “Fiscal Year Report.” Other useful measurements of return are the income yield on page 45 of this report which ignores market value changes, or simply the growth in income earned on page 12.

OPERATIONS

Activity—	Dollar volume, excluding repurchase agreements, increased over 83% to \$3.13 billion. Bankers’ Acceptances and commercial paper volumes grew 45% and 140% respectively as spreads widen versus treasury bills. Transaction volume increased almost 14%.
Lending—	The Securities Lending Program generated a record \$566,000 of income in Fiscal 1985, an impressive 62% gain from the previous year. This source of income is dependent on market volatility.
Audit—	In compliance with constitutional requirements, the investment records have been audited annually since the Board’s inception. The audit for Fiscal 1985 has been completed and is summarized by the Auditor’s report found on pages 24, 28, 32 and 37 of this publication.
Cost—	The Montana Board of Investments is one of the lowest cost state investment operations in the nation, if not the lowest. Total operating expenses declined, relative to assets managed, to .038 percent or \$380 per million dollars. This compares favorably to the .33 percent of assets fee charged by the average U.S. investment manager in a survey conducted by Greenwich Research Associates. Our employees’ dedication to assuring an efficient and highly accountable performance is to be commended.

Legislative Activity—49th Legislature

Joint Interim Subcommittee No. 3 published the results of its study entitled “Effective Management of State Investments” in which it recommended enactment of bills to:

- (1) provide representation from the boards of the Public Employees’ Retirement System and the Teachers’ Retirement System on the Board of Investments; (Passed)
- (2) authorize securities of the Federal Home Loan Mortgage Corporation to be pledged to secure deposits of public funds and thus qualify those securities as permissible investments for public funds; (Passed)
- (3) increase from two to six the number of positions on the staff of the Board of Investments exempted from the provisions of the state classification plan; (Defeated)
- (4) submit to the electorate a constitutional amendment to remove the restrictions on the investment of public funds and to provide that the “Prudent Expert” principle govern the investment of public funds; (Defeated)
- (5) conform the unified investment program with the constitutional amendments proposed in (4) and eliminate the statutory “laundry list” of permissible investments that dilutes the discretionary authority of the Board of Investments to make investment decisions. (Passed as amended)

The Unified Investment Program was amended by substituting the “Prudent Expert” standard for the “laundry list” for investment of public funds effective October 1, 1985.

Board Changes

Board member Gregory C. Jergeson’s term expired January 1, 1985. Greg was particularly supportive in Legislative matters.

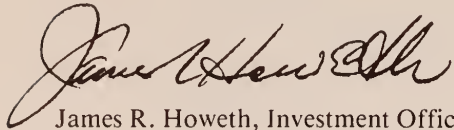
Eldon E. Kuhns resigned from the Board effective January 1, 1985. Eldon contributed valued financial expertise during his brief term. Gary Buchanan from Billings was appointed to fill the remaining two year term.

New Board members are Wilbur Scott from Great Falls, Patrick McKelvey from Helena, and J. William Kearns, Jr. from Townsend. The expanded Board now includes representatives from the Teachers’ Retirement System (Mr. Kearns) and from the Public Employees Retirement System (Mr. McKelvey) as passed by the 1985 Legislature.

Outlook for Fiscal 1986

The domestic economy is late in the business cycle, a phase normally marked by increasing market volatility. Significant volatility is expected to continue as the effects of both fiscal and monetary stimuli geared to revitalize the slumping economy are weighed against deficit reduction and tax reform. Fiscal policy and tax incentives appear to be ineffective in sustaining the rate of economic growth heralded by the Administration's supply side theology. Consequently, investment strategy for Fiscal 1986 must be designed with the knowledge that an economic slowdown, though no thought to be eminent, is included in many 1986 economic projections.

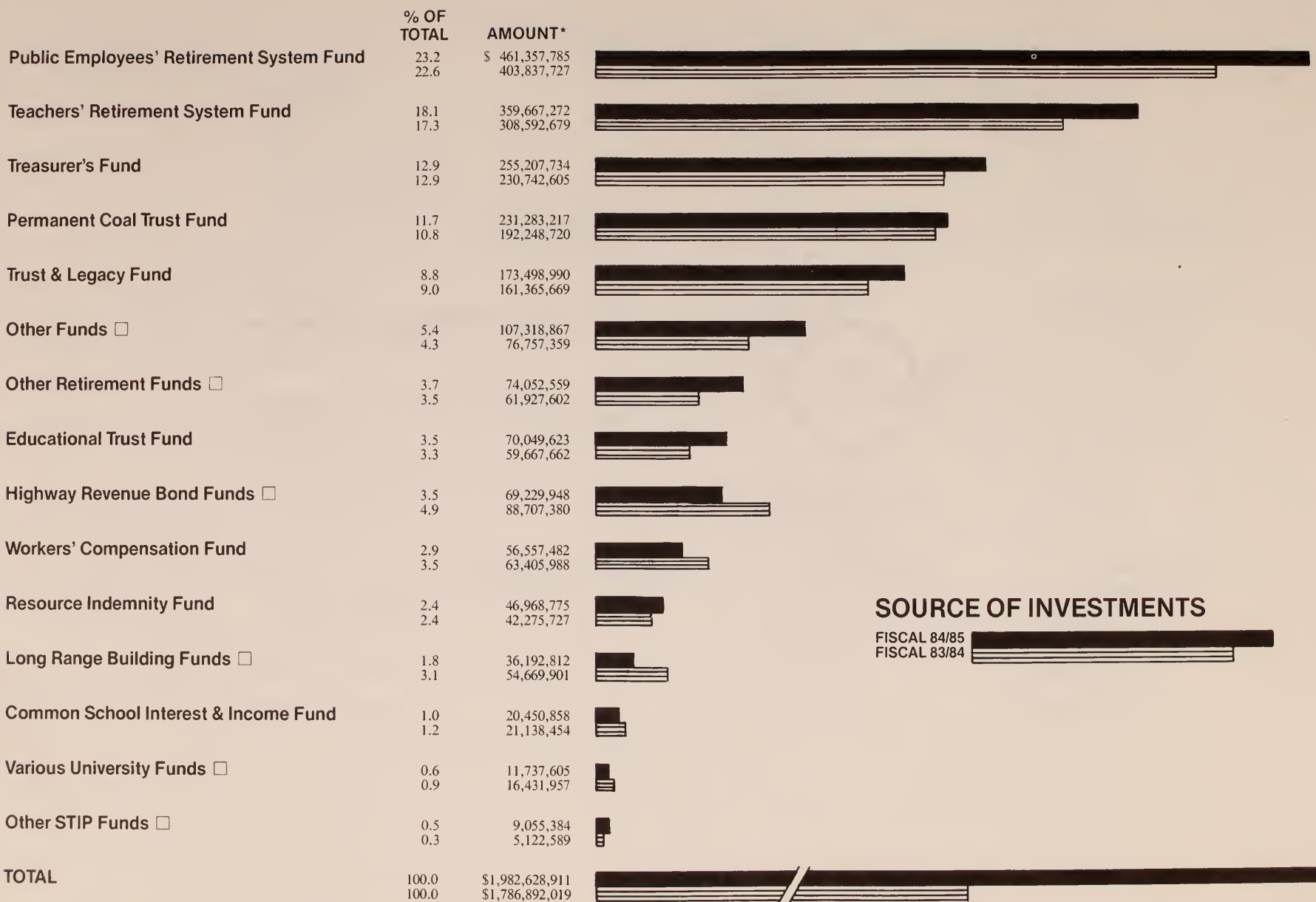
Respectfully submitted,

A handwritten signature in black ink, appearing to read "James R. Howeth". The signature is fluid and cursive, with the first name "James" being the most prominent.

James R. Howeth, Investment Officer

A handwritten signature in black ink, appearing to read "James R. Penner". The signature is fluid and cursive, with the first name "James" being the most prominent.

James R. Penner, Assistant Investment Officer



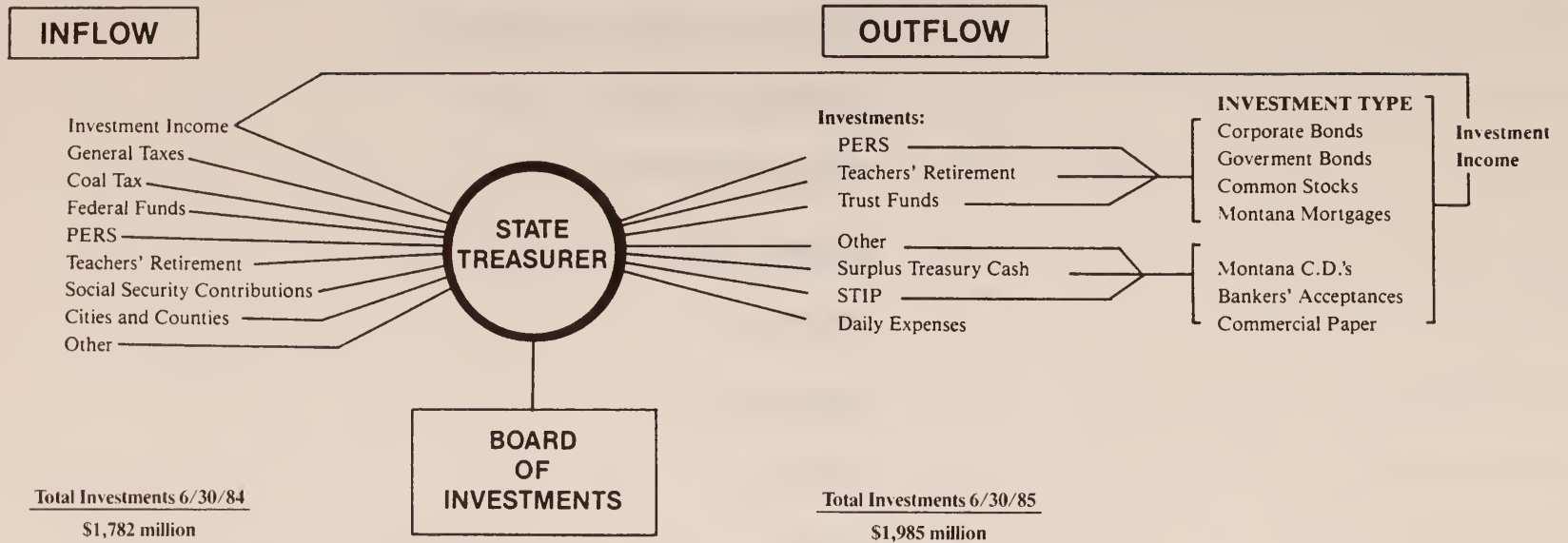
SOURCE OF INVESTMENTS

FISCAL 84/85
FISCAL 83/84

* Stated at Amortized Cost—See footnote p. 45

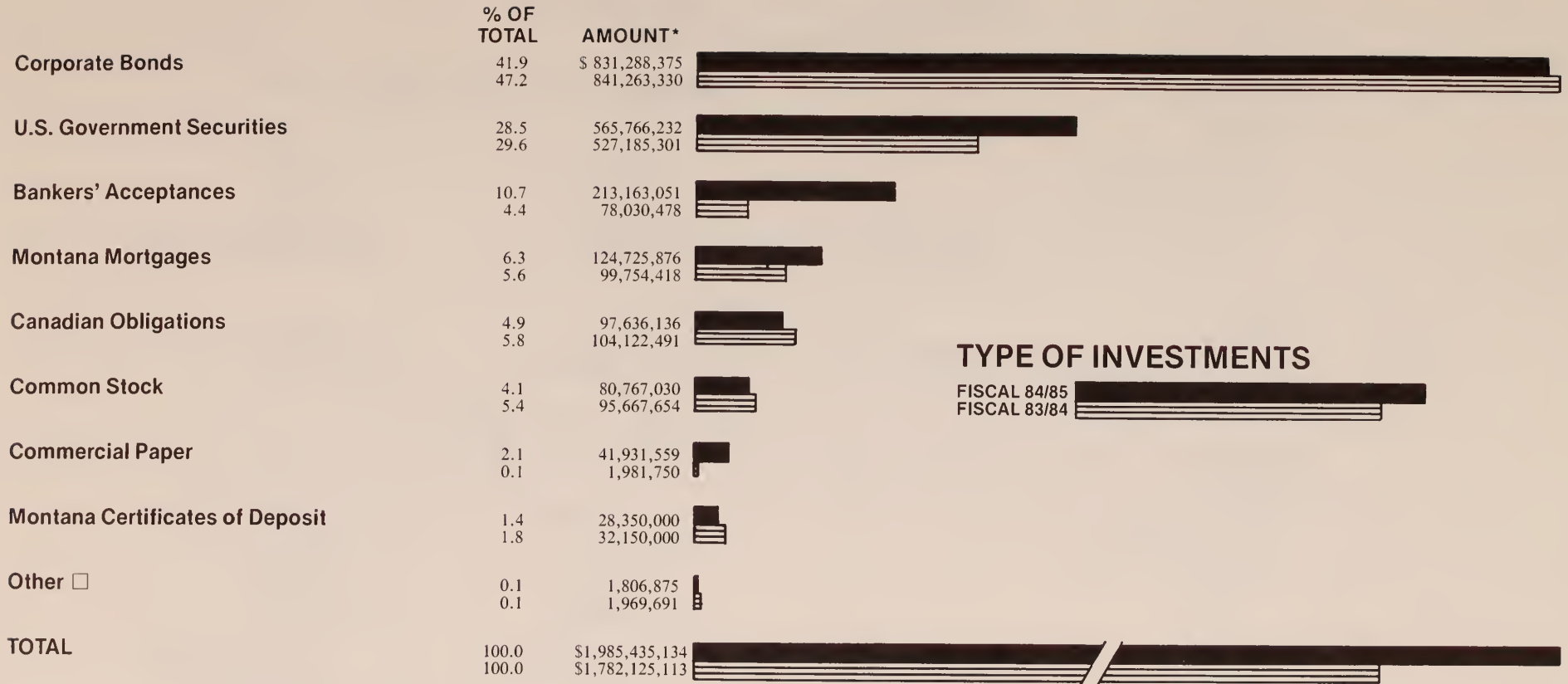
☐ See Schedule A

FLOW OF FUNDS



SUMMARY OF SECURITY TRANSACTIONS FISCAL YEAR 1984-1985

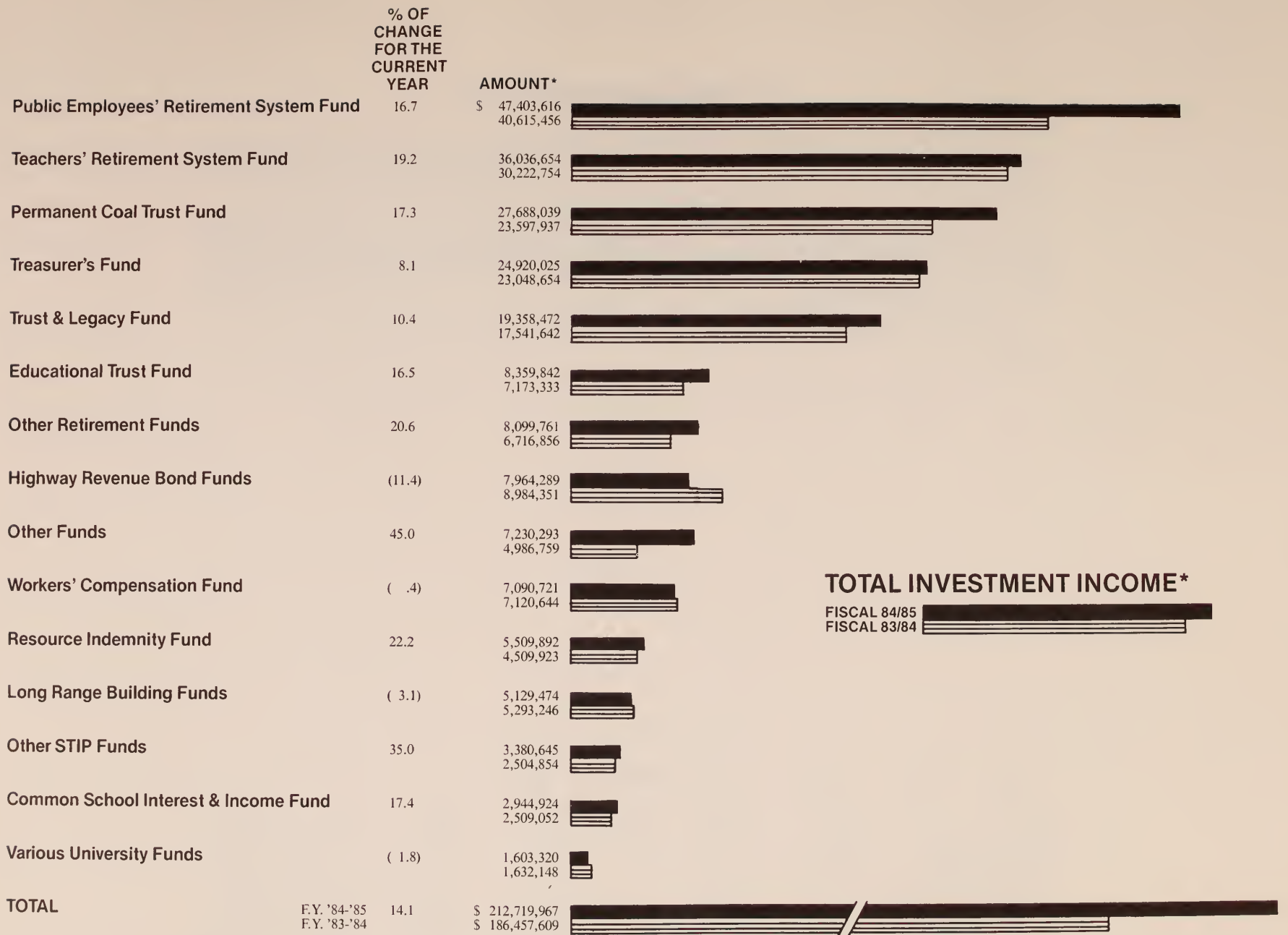
SHORT-TERM	PAR VALUE	COST/PROCEEDS
Purchases:		
Bankers' Acceptances	\$ 1,238,011,000	\$ 1,225,918,120
Certificates of Deposit	56,150,000	56,150,000
Commercial Paper	303,900,000	301,449,769
Government Securities	474,385,000	456,455,435
Repurchase Agreements	<u>10,195,400,000</u>	<u>10,195,400,000</u>
Total	\$ <u>12,267,846,000</u>	\$ <u>12,235,373,324</u>
Sales:		
Short-Term	\$ 136,890,000	\$ 134,966,074
TOTAL SHORT-TERM TRANSACTIONS	\$ <u>12,404,736,000</u>	\$ <u>12,370,339,398</u>
 LONG-TERM		
Purchases:		
Common Stock-Shares 288,340	\$ 0	\$ 4,593,551
Corporate Bonds	189,233,720	175,317,179
Government Securities	360,971,185	349,638,450
Mortgages	<u>33,331,181</u>	<u>33,216,763</u>
Total	\$ <u>583,536,086</u>	\$ <u>562,765,943</u>
Sales:		
Common Stock-Shares 721,366	\$ 0	\$ 26,124,114
Corporate Bonds	189,700,257	180,664,321
Government Securities	<u>355,755,303</u>	<u>356,528,983</u>
Total	\$ <u>545,455,560</u>	\$ <u>563,317,418</u>
TOTAL LONG-TERM TRANSACTIONS	\$ <u>1,128,991,646</u>	\$ <u>1,126,083,361</u>
TOTAL TRANSACTIONS	\$ <u><u>13,533,727,646</u></u>	\$ <u><u>13,496,422,759</u></u>
 TOTAL NUMBER OF TRANSACTIONS		4,326



TYPE OF INVESTMENTS

FISCAL 84/85
FISCAL 83/84

* Stated at Amortized Cost—See footnote p. 45
☐ See Schedule D



* Modified Income plus Accrued Income

TREASURER'S FUND

Surplus treasury cash is invested in short-term securities to assure liquidity necessary to meet seasonal cash flow requirements. May and June are generally peak months due to tax receipts while March and early April are slack months.

For fiscal 1985, the average invested balance increased 17.6% to \$260 million and investment income increased 8.1% to \$24.9 million. The investment income yield, calculated by dividing net yearly income by the average daily invested balance, was 9.58% in 1985 versus a yield of 10.45% last year. The larger average invested balance resulted from the issuance of tax anticipation notes in fiscal 1985. A lower investment yield was realized because interest rates declined significantly during the year.

Approximately \$238 million in investment income has been earned for Montana's treasury fund in the past fourteen years.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Bankers' Acceptances	\$ 35,971,240	15.6	\$ 88,958,750	34.9	147.3
Commercial Paper	0	0.0	8,832,289	3.4	-
Short Term Investment Pool	128,542,153	55.7	122,561,877	48.0	(4.7)
U.S. Government Securities	66,229,212	28.7	34,854,818	13.7	(47.4)
TOTAL INVESTMENTS	<u>\$ 230,742,605</u>	<u>100.0</u>	<u>\$ 255,207,734</u>	<u>100.0</u>	<u>10.6 %</u>

SHORT-TERM INVESTMENT POOL

STIP provides a short-term investment alternative for participants who have small amounts to invest. During 1985 STIP had 84 participants including 5 university units, 17 local governments and 62 State accounts.

Participants in STIP earned an average yield of 10.10% in Fiscal 1985 compared to 10.60% last year. The reduced yield resulted from significantly lower interest rates and a planned objective of reducing the average portfolio maturity to less than one year.

This strategy facilitates changing to a constant unit value basis of accounting substantially reducing the volatility previously associated with STIP.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Bankers' Acceptances	\$ 15,289,283	6.7	\$ 71,945,093	29.8	370.6
Canadian Obligations	6,955,280	3.1	502,500	0.2	(92.8)
Commercial Paper	1,981,750	0.9	14,323,246	5.9	622.8
Corporate Obligations	63,197,426	27.9	10,990,390	4.6	(82.6)
Montana Certificates of Deposit	32,150,000	14.2	28,250,000	11.7	(12.1)
U.S. Government Securities	106,984,169	47.2	115,394,331	47.8	7.9
TOTAL INVESTMENTS	\$ 226,557,908	100.0	\$ 241,405,560	100.0	6.6 %

PUBLIC EMPLOYEES' RETIREMENT SYSTEM FUND

The Public Employees' Retirement System's (PERS) invested balance, stated at book value, increased 14.2% to \$461 million. The \$57.5 million increase is the net difference between participant contributions plus investment income less the disbursements for benefits and expenses.

Investment income advanced 16.7% to \$47.4 in fiscal 1985. The income yield improved to 11.59% compared to 11.34% in the previous year.

PERS has over 27,000 active participants and 8,025 retired employees receiving benefits.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Bankers' Acceptances	\$ 3,184,769	0.8	\$ 6,246,427	1.3	96.1
Canadian Obligations	24,903,066	6.2	24,722,332	5.3	(0.7)
Commercial Paper	0	0.0	6,756,159	1.5	—
Common Stock	51,769,756	12.8	55,768,439	12.1	7.7
Corporate Obligations	221,538,424	54.9	232,373,288	50.4	4.9
Land and Building	135,966	0.0	130,655	0.0	(3.9)
Montana Mortgages	52,248,151	12.9	64,901,240	14.1	24.2
Montana Obligations	324,030	0.1	390,972	0.1	(20.7)
U.S. Government Securities	49,733,565	12.3	70,068,273	15.2	40.9
TOTAL INVESTMENTS	\$ 403,837,727	100.0	\$ 461,357,785	100.0	14.2 %

TEACHERS' RETIREMENT SYSTEM FUND

The Teachers' Retirement System (TRS) is the second largest fund managed by the Board of Investments. On June 30, 1985, total investments, stated at book value, were \$359.6 million or 16.6% greater than a year ago. Investment income rose 19.2% to \$36.0 million in Fiscal 1985. Over \$210 million has been earned by the fund's investments since the Board assumed management. The income yield increased to 11.40% in Fiscal 1985 compared to a return of 11.12% last year.

No major changes in the portfolio mix in dollar terms were made during the year. An additional \$12.1 million was invested in Montana mortgages bringing the total mortgage investment to \$58.4 million.

Additional performance statistics are presented in detail on page 21. As shown there, TRS's bond performance over the nine years produced a 10.4% annual rate of return compared to a 8.8% annual rate of return registered by the Salomon Brothers Index.

Teachers's Retirement System has over 15,400 active participants and 5,477 participants receiving retirement benefits.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Bankers' Acceptances	\$ 3,972,878	1.3	\$ 5,915,490	1.6	48.9
Canadian Obligations	24,107,865	7.8	23,841,738	6.6	(1.1)
Commercial Paper	0	0.0	2,979,774	0.8	—
Common Stock	43,751,557	14.2	48,750,694	13.6	11.4
Corporate Obligations	149,408,349	48.4	160,044,555	44.5	7.1
Land and Building	1,459,695	0.5	1,397,248	0.4	(4.3)
Montana Mortgages	46,304,688	15.0	58,413,276	16.2	26.1
Montana Obligations	0	0.0	162,000	0.1	—
U.S. Government Securities	39,587,647	12.8	58,162,497	16.2	46.9
TOTAL INVESTMENTS	\$ 308,592,679	100.0	\$ 359,667,272	100.0	16.6 %

TRUST & LEGACY FUND

The Trust and Legacy Fund is a permanent fund whose income is used to support Montana schools. All but 5% of the income earned by the portfolio is distributed, primarily to local school districts. The 5% is added to principal.

Investment income climbed 10.4% to \$19.3 million and assets at cost grew 7.5% to \$173.5. Through an active bond swapping program, the income yield increased to 12.27% versus 11.96% last year.

Invested solely in fixed income securities, the Trust & Legacy Fund has registered a 10.4% annual return over the past nine years. This return compares favorably with returns of 8.8% and 9.8% posted by the Salomon Brothers Index and Shearson Lehman Corp. Index, respectively, for the same period.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Bankers' Acceptances	\$ 3,549,302	2.2	\$ 2,185,567	1.3	(38.4)
Canadian Obligations	12,494,713	7.8	12,327,429	7.1	(1.3)
Commercial Paper	0	0.0	5,268,729	3.0	—
Corporate Obligations	112,501,114	69.7	115,405,254	66.5	2.6
U.S. Government Securities	32,820,540	20.3	38,312,011	22.1	16.7
TOTAL INVESTMENTS	\$ 161,365,669	100.0	\$ 173,498,990	100.0	7.5 %

PERMANENT COAL TRUST FUND

Total assets of the Coal Trust Fund grew by 20.3% to \$231.2 million. Investment income increased by 17.3% to \$27.6 million. The income yield was 13.99% compared to 14.42% last year. The yield dropped due to lower reinvestment rates for called and sold bond proceeds.

Fifteen percent of the annual income is reinvested as principal and 25% of the principal contributions is credited to the Economic Development Board for in-state investing.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Canadian Obligations	\$ 17,912,730	9.3	\$ 18,917,726	8.2	5.6
Corporate Obligations	123,010,822	64.0	135,223,552	58.5	9.9
Montana Certificates of Deposit	0	0.0	100,000	0.0	—
Montana Mortgages	904,583	0.5	1,139,696	0.5	26.0
Short Term Investment Pool	10,076,805	5.2	19,383,100	8.4	92.4
U.S. Government Securities	40,343,781	21.0	56,519,143	24.4	40.1
TOTAL INVESTMENTS	\$ 192,248,721	100.0	\$ 231,283,217	100.0	20.3%

WORKERS' COMPENSATION FUND

The Workers' Compensation Fund is funded by monies derived from the State-administered industrial accident insurance program.

Investment income declined by .4% to \$7.1 million in fiscal 1985. Assets at cost declined 10.8% to \$56.5 million. The increase in income yield resulted from sale of low yielding securities to meet periodic withdrawals.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Canadian Obligations	\$ 6,127,321	9.6	\$ 6,154,441	10.9	0.4
Corporate Obligations	48,260,411	76.1	43,496,950	76.9	(9.9)
Montana Mortgages	230,867	0.4	209,761	0.4	(9.1)
U.S. Government Securities	8,787,389	13.9	6,696,330	11.8	(23.8)
TOTAL INVESTMENTS	\$ <u>63,405,988</u>	<u>100.0</u>	\$ <u>56,557,482</u>	<u>100.0</u>	<u>(10.8)%</u>

EDUCATIONAL TRUST FUND

Investment income grew 16.5% to \$8.4 million while assets advanced 17.4% to \$70.0 million at cost. The income yield was 13.78% in 1985 and 13.88 in 1984. Called and sold bond proceeds were reinvested at lower rates resulting in a lower income yield.

The Educational Trust receives ten percent of coal severance taxes and ten percent of annual income is reinvested each year. Ninety percent of annual income is remitted to the public schools and university systems in Montana.

ANALYSIS OF INVESTMENTS

Type:	Fiscal Cost	83/84 %	Fiscal Cost	84/85 %	% Change
Canadian Obligations	\$ 2,636,551	4.4	\$ 2,255,281	3.2	(14.5)
Corporate Obligations	46,917,440	78.6	51,574,671	73.6	9.9
Short Term Investment Pool	1,458,893	2.5	3,201,799	4.6	119.5
U.S. Government Securities	8,654,777	14.5	13,017,872	18.6	50.4
TOTAL INVESTMENTS	\$ 59,667,661	100.0	\$ 70,049,623	100.0	17.4 %

PERFORMANCE COMPARISONS

Annualized Time-Weighted Total Rates of Return

	Annual Return 9 Years 1977-85	Fiscal Year 1977 %	Fiscal Year 1978 %	Fiscal Year 1979 %	Fiscal Year 1980 %	Fiscal Year 1981 %	Fiscal Year 1982 %	Fiscal Year 1983 %	Fiscal Year 1984 %	Fiscal Year 1985 %
COMMON STOCK:										
MONTANA	13.7	4.0	3.3	14.7	15.7	22.1	-11.3	59.9	- 4.8	35.1
A. G. Becker 1st Quartile*	N/A	2.3	4.9	15.9	22.8	29.3	- 9.1	74.0	- 4.8	33.9
A. G. Becker Median	N/A	- 2.6	2.3	13.0	17.2	23.8	-13.2	66.0	-10.9	30.3
S&P 500	12.5	0.6	0.1	13.6	17.4	20.4	-11.4	61.2	- 4.6	31.3
Dow Jones Industrial Average	9.1	- 4.4	-5.4	9.2	9.7	19.2	-11.3	58.3	- 2.9	24.0
BONDS:										
MONTANA (total)****	10.4	15.1	-0.3	7.5	- 1.5	-10.4	12.3	45.8	- 2.4	40.6
A. G. Becker 1st Quartile	N/A	13.8	2.6	8.2	6.1	- 3.3	13.4	33.2	3.6	31.4
A. G. Becker Median	N/A	12.8	1.5	7.4	3.5	- 6.1	11.7	29.0	1.1	28.1
Shearson Lehman Corp. Index**	9.8	15.1	0.4	7.1	- 1.0	- 8.6	11.9	39.5	- 1.4	34.8
Salomon Brothers Index***	8.8	15.1	-0.8	7.2	- 2.4	-12.9	8.6	42.4	- 6.3	41.9
Public Employees' Retirement Fund	10.6	15.1	0.0	7.3	- 1.7	-10.6	12.1	48.3	- 2.9	41.3
Teachers' Retirement Fund	7.0	14.4	0.6	7.0	- 1.0	-11.6	12.2	47.1	- 3.2	41.5
Trust & Legacy Fund	10.4	16.2	-2.5	7.9	- 1.8	- 7.7	12.4	42.3	- 1.7	41.4
Workers' Compensation Fund	9.4	13.9	0.9	7.9	- 1.4	-11.4	9.1	38.9	- 2.7	42.1
Permanent Coal Trust Fund	N/A						13.3	51.3	- 1.5	38.1
Educational Trust Fund	N/A						15.1	45.7	- 1.8	38.6
Consumer Price Index	7.4	6.9	7.4	10.9	14.3	9.6	7.1	2.6	4.2	3.7

*The S.E.I. sample includes over 3,000 managed funds throughout the country. The sample is ranked by performance results. For example, the 1st quartile figures are the minimum return generated by the top 25 percent of the sample; said differently, 75 percent of all money managers surveyed had returns below this figure.

**This index is comprised of all publicly issued, non-convertible, domestic debt of industrial, utility, and financial issuers. Bonds included have a rating of at least Baa by Moody's or BBB by Standard & Poor's. In the case of bank bonds, minimum rating is BBB by Fitch. Debt maturing within one year is omitted. The minimum outstanding par value is \$1,000,000. Currently, there are over 5,000 issues included in the index.

***This index is comprised of all non-convertible industrial and utility bonds which were originally publicly offered with a maturity of 1990 or later, a Standard & Poor's quality rating of AAA or AA, and an outstanding par value of at least \$25,000,000. Currently, there are 825 issues in the index.

****Excludes Permanent Coal and Educational Trust Fund prior to 1982.

FINANCIAL STATEMENTS

AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments Short-Term Investment Pool as of June 30, 1985, the related Statement of Investment Income and Distributions and Statement of Changes in Investments Managed for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of the State of Montana Board of Investments Short-Term Investment Pool for the year ended June 30, 1984, were examined by other auditors whose report dated September 12, 1984, expressed an unqualified opinion on those statements.

In our opinion, the financial statements referred to above present fairly the investments managed by the State of Montana Board of Investments Short-Term Investment Pool as of June 30, 1985 and 1984, and its investment income and distributions and changes in its investments managed for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of investment income (Schedule B) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Respectfully,

James Gillett, CPA
Deputy Legislative Auditor

September 27, 1985

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL**

**STATEMENT OF INVESTMENTS MANAGED
JUNE 30, 1985 and 1984**

	<u>1985</u>	<u>1984</u>
Cash	\$ 57,672	\$ 41,105
Interest receivable	5,059,841	5,378,210
Investments managed at current value (cost of \$241,405,560 in 1985 and \$226,557,908 in 1984) (Note 2)	<u>245,169,148</u>	<u>219,720,208</u>
TOTAL ASSETS	250,286,661	225,139,523
Accrued expenses	<u>(23,091)</u>	<u>(23,091)</u>
Value of units	250,263,570	225,116,432
Income due participants	<u>(1,815,756)</u>	<u>(2,106,583)</u>
Net asset value	\$ <u><u>248,447,814</u></u>	\$ <u><u>223,009,849</u></u>
Units outstanding	255,619	241,709
Unit value	\$ 979.05	\$ 931.35

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL**

**STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE YEARS ENDED JUNE 30, 1985 and 1984**

	<u>1985</u>	<u>1984</u>
Net asset value, beginning of year	\$ 223,009,849	\$ 243,775,573
Value of units purchased by participants	166,731,356	157,669,166
Changes in current value of investments managed	12,246,710	(8,044,722)
Value of units sold by participants	<u>(153,540,101)</u>	<u>(170,390,168)</u>
Net asset value, end of year	\$ <u><u>248,447,814</u></u>	\$ <u><u>223,009,849</u></u>

The accompanying notes are an integral part
of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS SHORT-TERM INVESTMENT POOL

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTIONS FOR THE YEARS ENDED JUNE 30, 1985 and 1984

	<u>1985</u>	<u>1984</u>
Interest income	\$ 24,655,404	\$ 25,667,202
Administrative expenses (Note 2)	<u>(271,881)</u>	<u>(272,626)</u>
Net income	24,383,523	25,394,576
Income purchased by participants	4,733,071	4,804,005
Income due participants, beginning of year	<u>2,106,583</u>	<u>2,086,737</u>
Income available for distribution	\$ <u><u>31,223,177</u></u>	\$ <u><u>32,285,318</u></u>
Income distributed on units sold (Note 2)	4,224,588	5,096,605
November distribution (Note 2)	12,944,740	12,537,439
May distribution (Note 2)	<u>12,238,093</u>	<u>12,544,691</u>
Total distributions	\$ <u><u>29,407,421</u></u>	\$ <u><u>30,178,735</u></u>
Income due participants, end of year	\$ <u><u>1,815,756</u></u>	\$ <u><u>2,106,583</u></u>

The accompanying notes are an integral part
of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1985**

1. HISTORY AND ORGANIZATION:

The State of Montana Board of Investments (Board) was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Short-Term Investment Pool (STIP) provides a short-term investment vehicle to participants (state and local governmental units) with a relatively small amount to invest. Investment in STIP affords the participant liquidity and a return on their investment. The investments and the income of STIP are owned by the participants as they purchase units and are managed on their behalf by the Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Administrative Expenses

Administrative expenses incurred by the Board are charged to STIP daily based on the Board's expenses applicable to STIP.

Income Distribution

The value of units purchased or sold includes a daily computation of net asset value and income; therefore, income to point of sale is included in proceeds to the seller. Cash distributions of income are made to continuing participants on the last working day in the months of May and November. The amounts shown for value of units purchased and sold by participants are net of income purchased and income sold, respectively.

Money Max System

The Board utilizes an automated system (Money Max) for STIP accounting. Money Max automatically accrues investment income and expenses, computes unit values, etc., on an individual fund basis. Current values for investments are determined by Money Max through direct computer access from a New York securities valuation firm. Investments are presented in the statements of investments managed at current value. The value of investments managed is adjusted daily for changes in the current value.

Securities Lending

The Board has an agreement with Manufacturers Hanover Trust Company (Manufacturers) whereby Manufacturers would loan to other entities securities managed by the Board. During the period the securities are on loan, the Board receives a fee and Manufacturers must maintain collateral equal to 102% of the market value of the securities loaned. The Board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial statements is \$94,885 for the year ended June 30, 1985 and \$95,148 for the year ended June 30, 1984 of income from securities lending activities. At June 30, 1985, approximately \$31,373,607 and at June 30, 1984 approximately \$31,148,312 of securities included in these financial statements had been loaned by Manufacturers to other entities.

AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments Montana Common Stock Pool as of June 30, 1985 and the related Statement of Investment Income and Distributions and Statement of Changes in Investments Managed for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of the State of Montana Board of Investments Montana Common Stock Pool for the year ended June 30, 1984, were examined by other auditors whose report dated September 12, 1984, expressed an unqualified opinion on those statements.

In our opinion, the financial statements referred to above present fairly the investments managed by the State of Montana Board of Investments Montana Common Stock Pool as of June 30, 1985 and 1984, and its investment income and distributions and changes in its investments managed for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of investment income (Schedule B) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Respectfully,

James Gillett, CPA
Deputy Legislative Auditor

September 27, 1985

STATE OF MONTANA BOARD OF INVESTMENTS MONTANA COMMON STOCK POOL

STATEMENT OF INVESTMENTS MANAGED JUNE 30, 1985 and 1984

	<u>1985</u>	<u>1984</u>
Cash	\$ 31,656	\$ 11,523
Dividend receivable	474,888	565,693
Interest receivable	577,721	35,795
Investments managed at current value (cost of \$121,026,155 in 1985 and \$103,084,245 in 1984)	<u>172,497,084</u>	<u>129,540,845</u>
TOTAL ASSETS	173,581,349	130,153,856
Income due participants	(2,227)	(2,899)
Net asset value	\$ <u><u>173,579,122</u></u>	\$ <u><u>130,150,957</u></u>
Units outstanding	110,027	101,389
Unit value	\$ 1,577.60	\$ 1,283.68

STATE OF MONTANA BOARD OF INVESTMENTS MONTANA COMMON STOCK POOL

STATEMENT OF CHANGES IN INVESTMENTS MANAGED FOR THE YEARS ENDED JUNE 30, 1985 and 1984

	<u>1985</u>	<u>1984</u>
Net asset value, beginning of year	\$ 130,150,957	\$ 130,046,761
Transfer of stock at market and cash to pool (Note 2)	0	0
Value of units purchased by participants (Note 2)	11,783,829	11,701,005
Value of units sold by participants (Note 2)	0	(71,681)
Changes in current value of investments managed	<u>31,644,336</u>	<u>(11,525,128)</u>
Net asset value, end of year	\$ <u><u>173,579,122</u></u>	\$ <u><u>130,150,957</u></u>

The accompanying notes are an integral part
of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA COMMON STOCK POOL**

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTIONS
FOR THE YEARS ENDED JUNE 30, 1985 and 1984**

	<u>1985</u>	<u>1984</u>
Interest income	\$ 8,593,485	\$ 7,623,001
Income due participants, beginning of year	<u>2,899</u>	<u>1,170</u>
Income available for distribution	8,596,384	7,624,171
Distribution (Note 2)	<u>(8,594,157)</u>	<u>(7,621,272)</u>
Income due participants, end of year	\$ <u><u>2,227</u></u>	\$ <u><u>2,899</u></u>

The accompanying notes are an integral part
of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA COMMON STOCK POOL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1985**

1. HISTORY AND ORGANIZATION:

The State of Montana Board of Investments (Board) was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Montana Common Stock Pool (Mont-Comp) was created in order to allow smaller retirement funds the opportunity to participate in the equity market via a diversified pool.

Mont-Comp was created as of July 1, 1980 by the transfer from all other funds to Mont-Comp of all common stock owned by the Public Employees' Retirement System and the Teachers' Retirement System.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Public Employees' Retirement System and the Teachers' Retirement System transferred virtually all stock owned into Mont-Comp at the start-up date and were issued units according to the market value of their contribution, retaining their original total cost basis.

The initial unit value as of July 1, 1980 was \$1,000. Unit values thereafter are calculated once a month at the close of the last business day of the month based upon the market value of the Mont-Comp equity holdings and other assets. Participants may only buy or sell units on the first business day of each month.

Mont-Comp distributes to each participant investment income on the last business day of each month. This distribution is based on the full accrual basis so that all dividends and interest accrued during the month are returned to the participants based on the number of their units outstanding.

3. SECURITIES LENDING:

The Board has an agreement with Manufacturers Hanover Trust Company (Manufacturers) whereby Manufacturers would loan to other entities securities managed by the Board. During the period the securities are on loan, the Board receives a fee and Manufacturers must maintain collateral equal to 102% of the market value of the securities loaned. The Board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial statements \$27,929 for the year ended June 30, 1985 and \$27,233 for the year ended June 30, 1984 of income from securities lending activities. At June 30, 1985, approximately \$13,345,182 and at June 30, 1984 approximately \$8,369,954 of securities included in these financial statements had been loaned by Manufacturers to other entities.

AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Schedule of Investments Managed by the State of Montana Board of Investments All Other Funds as of June 30, 1985, the related Schedule of Investment Income and Distributions and Schedule of Changes in Investments Managed for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note 2 to the financial schedules, the Board of Investments' financial schedules are prepared in accordance with state accounting policy. Accordingly, the accompanying financial schedules are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial schedules referred to above present fairly the investments managed by the State of Montana Board of Investments All Other Funds as of June 30, 1985 and its investment income and distributions and changes in its investments managed for the fiscal year then ended, in conformity with the basis of accounting described in Note 2 applied on a consistent basis.

Our examination was made for the purpose of forming an opinion on the basic financial schedules taken as a whole. The schedule of investment income (Schedule B) is presented for purposes of additional analysis and is not a required part of the basic financial schedules. Such information has been subjected to the auditing procedures applied in the examination of the basic financial schedules and, in our opinion, is fairly stated in all material respects in relation to the basic financial schedules taken as a whole.

Respectfully,

James Gillett, CPA
Deputy Legislative Auditor

September 27, 1985

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS**

**SCHEDULE OF INVESTMENTS MANAGED
JUNE 30, 1985**

	<u>1985</u>
Investments managed at book value (current value of \$1,662,579,939 in 1985) (Note 2)	\$ 1,613,966,905
Dividends and interest receivable	41,681,972
Net unamortized deferred losses on bond swaps (Note 2)	42,693,069
Interest purchased receivable	<u>1,216,483</u>
Total investments managed	\$ <u><u>1,699,558,429</u></u>

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS**

**SCHEDULE OF INVESTMENT INCOME
JUNE 30, 1985**

	<u>1985</u>
INCOME:	
Interest income	\$ 182,788,245
Dividend income	5,106
Realized gain on sale of investments	1,057,055
Rental income	<u>27,252</u>
	\$ <u><u>183,877,658</u></u>
EXPENSES:	
Administrative expenses	(466,753)
Net amortization of deferred losses on bond swaps (Note 2)	<u>(4,015,412)</u>
	\$ <u><u>(4,482,165)</u></u>
Net investment income	\$ <u><u>179,395,493</u></u>

The accompanying notes are an integral part
of these financial schedules.

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS**

**SCHEDULE OF CHANGES IN INVESTMENTS MANAGED
JUNE 30, 1985**

		<u>1985</u>
TOTAL INVESTMENTS MANAGED, BEGINNING OF YEAR		\$ 1,538,720,291
Net investment income	\$ 179,395,493	
Income remitted to agencies	<u>(177,467,214)</u>	
Increase in dividends and interest receivable		1,928,279
Interest purchased during the year	5,807,680	
Collection of interest purchased during the year	<u>(6,380,266)</u>	
Increase in interest purchased receivable		(572,586)
Net bond swap gains/losses incurred during the year	2,013,913	
Net amortization of deferred bond swap losses	<u>(4,015,412)</u>	
Increase (decrease) in net unamortized deferred gains/losses on bond swaps		(2,001,499)
Increase in book value of invest- ments due to net amortization of discounts and premiums		4,665,599
Investments purchased	8,406,563,426	
Investments sold and matured	<u>(8,249,745,081)</u>	
Increase in book value of investments purchased		<u>156,818,345</u>
TOTAL INVESTMENTS MANAGED, END OF YEAR		\$ <u><u>1,699,558,429</u></u>

The accompanying notes are an integral part
of these financial schedules.

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS
NOTES TO FINANCIAL SCHEDULES
JUNE 30, 1985**

1. HISTORY AND ORGANIZATION:

The State of Montana Board of Investments (the Board) was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The investments and the income therefrom are owned by various State of Montana agency funds and managed on their behalf by the Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Investments

Investments, except mortgages, are presented in the schedule of investments managed at book value (original cost adjusted for discount and premium amortization where applicable). Mortgages are presented in the schedule of investments managed at par value. Mortgage discounts are recorded in the accounting records of the applicable administering agencies. Current values for publicly traded securities are determined primarily by reference to market prices supplied to the Board by various brokerage houses. Unrealized market loss on investments managed decreased by \$119,439,218 in 1985. The investments managed relate principally to investments which will be held or otherwise disposed of at no significant loss to the fund.

Premium and discounts are amortized using the straight-line method over the life of the securities. An average life of eight years is used for amortization of mortgage discounts.

Bond Swaps

Bond swaps involve trading one security for another security having the same par value for the purpose of enhancing portfolio content and/or yield. The Board defers gains and losses resulting from bond swaps and amortizes such gains and losses over the shorter of either the remaining life of the bonds sold or the replacement bonds purchased. As shown in the accompanying financial schedules the accumulated net unamortized deferred losses on bond swaps as of June 30, 1985 and the net amortization of the deferred losses on bond swaps for the year follows:

	<u>June 30, 1985</u>
Accumulated net unamortized losses on bond swaps:	
Agencies other than Public Retirement Systems	\$ 15,313,247
Public Retirement Systems	<u>27,379,822</u>
Total	<u>\$ 42,693,069</u>

	<u>June 30, 1985</u>
Net amortization of deferred losses on bond swaps:	
Agencies other than Public Retirement Systems	\$ 1,501,057
Public Retirement Systems	<u>2,514,355</u>
Total	<u>\$ 4,015,412</u>

3. INVESTMENTS NOT UNDER DIRECT CONTROL

Land and buildings, the costs of which are also included in investments managed in the accompanying financial schedules, are not under direct control of the Board. The agencies administering these assets maintain control and provide the Board with the necessary financial information. Rental income from these buildings is included in the schedule of investment income; however, occupancy and depreciation charges relating to the buildings are not material and have not been included in the schedule of investment income.

The book value of land and buildings included in investments managed in the accompanying financial schedule was \$267,417 at June 30, 1985.

4. SECURITIES LENDING

The Board has an agreement with Manufactureres Hanover Trust Company (Manufacturers) whereby Manufacturers would loan to other entities securities managed by the Board. During the period the securities are on loan, the Board receives a fee and Manufacturers must maintain collateral equal to 102% of the market value of the securities loaned. The Board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial schedules is \$444,289 for the year ended June 30, 1985 of income from securities lending activities. At June 30, 1985 approximately \$120,885,896 of securities included in these financial schedules had been leased by Manufacturers to other entities.

AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments STIP II as of June 30, 1985, the related Statement of Investment Income and Distributions and Statement of Changes in Investments Managed for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the investments managed by the State of Montana Board of Investments STIP II as of June 30, 1985 and its investment income and distributions and changes in its investments managed for the fiscal year then ended, in conformity with generally accepted accounting principles.

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of investment income (Schedule B) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Respectfully,

James Gillett, CPA
Deputy Legislative Auditor

September 27, 1985

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL II**

**STATEMENT OF INVESTMENTS MANAGED
JUNE 30, 1985**

	<u>1985</u>
Cash	\$ 6,249
Interest receivable	17,751
Investments managed at cost	<u>9,036,514</u>
TOTAL ASSETS	9,060,514
Income due participants	<u>(5,114)</u>
NET ASSET VALUE	<u><u>\$ 9,055,400</u></u>
Units outstanding	90,554
Unit value	\$ 100.06

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL II**

**STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE YEAR ENDED JUNE 30, 1985**

	<u>1985</u>
Net asset value, beginning of year	\$ 0
Value of units purchased by participants	9,058,600
Value of units sold by participants	<u>(3,200)</u>
Net asset value, end of year	<u><u>\$ 9,055,400</u></u>

The accompanying notes are an integral part
of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL II**

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 1985**

	<u>1985</u>
Interest income	\$ 51,952
Income purchased by participants	4,794
Income due participants, beginning of year	<u>0</u>
Income available for distribution	\$ <u><u>56,746</u></u>
Income distributed on units sold (Note 2)	16
Distribution (Note 2)	<u>51,616</u>
Total distributions	\$ <u><u>51,632</u></u>
Income due participants, end of year	\$ <u><u>5,114</u></u>

The accompanying notes are an integral part
of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL II
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1985**

1. HISTORY AND ORGANIZATION:

The State of Montana Board of Investments (Board) was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis.

As of May 31, 1985, the Short-Term Investment Pool II (STIP II) was implemented as an eventual total precursor to STIP. The purpose of STIP II is to obtain the highest possible return, yet maintain a highly liquid position whereby funds may be invested for relatively short periods, one day or more, depending upon the participant's anticipated use of funds. The investments and the income of STIP II are owned by the participants as they purchase units and are managed on their behalf by the Board. At this time, participation in STIP II is limited to local governments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

STIP II distributes income as of the last business day of each month, with the option of having the income automatically re-invested in additional units. The total price to buy or sell a unit is reduced by the amount of the income distributed on each distribution date.

Participants who sell units between distribution dates receive the respective investment income in the total price of the unit at the date of sale.

The unit value is fixed at \$100 per unit. The total price to buy or sell a unit is \$100 plus the accrued income per unit. The income per unit is the amount of income accrued since the last monthly distribution.

A unit purchased by a participant begins accruing income on the day it is purchased and ceases to accrue income on the day before the unit is sold.

The portfolio of investments in STIP II is kept under one year in maturity and is carried at cost or amortized cost. This portfolio structure allows for the fixing of the worth of the unit.

SCHEDULE A SOURCE OF INVESTMENTS

Highway Revenue Bond Funds:	1983-1984	1984-1985
Highway Revenue Bond Construction Fund	\$ 32,820,884	\$ 27,524,974
Highway Revenue Bond Proceeds Fund	38,618,932	27,178,036
Highway Revenue Bond Debt Service Fund	13,154,663	12,812,418
Highway Revenue Capitalized Interest Fund	4,112,901	1,384,608
Highway Complex Sinking Fund	600,560	329,912
TOTAL	\$ 89,307,940	\$ 69,229,948

Other Funds:	1983-1984	1984-1985
Montana Instate Investments Fund	\$ 10,228,914	\$ 17,958,578
Group Benefits Fund	9,989,193	14,025,220
Coal Tax-Park Acquisition Fund	11,507,621	13,865,529
Social Security Fund	12,048,203	11,642,016
Agency Insurance Fund	7,993,784	7,866,749
Local Impact Fund	5,908,078	5,799,923
1984 Series A Bond Proceeds Fund	0	5,376,760
Hail Insurance Fund	3,598,880	3,610,805
Rail Construction Loan Fund	0	3,041,437
Guaranteed Student Loan Reserve Fund	1,764,451	3,012,858
BN Geraldine Settlement Connector Fund	0	3,003,599
Subsequent Injury Fund	2,497,235	2,562,090
BN Geraldine Settlement Fund	0	2,288,226
Group Insurance Fund	0	1,522,037
Debt Service Reserve Fund	0	1,206,927
Lands & Resource Development Fund	1,174,714	1,093,966
Livestock-Inspection & Control Fund	1,376,536	1,049,633
DNRC Water Development Fund	844,921	1,034,547
Woodville Highway Replacement Fund	896,970	829,736
Real Property Trust Fund	0	751,832
Crime Victims Compensation Fund	686,619	716,155
Section 155 Grant Fund	484,097	587,123
Uninsured Employers Fund	493,652	584,078
Board of Oil & Gas Fund	509,266	547,409
Operating Reserve Fund	288,324	454,818
Charles Bair Trust Fund	0	448,148
Livestock-Animal Health Emergency Fund	435,345	435,345
Flood Insurance Fund	318,169	367,298
Warner Amendment Fund	324,217	255,559
Montana Rural Rehabilitation Fund	180,103	252,694
Wheat Research & Marketing Fund	754,529	222,560
Livestock-Animal Health ERA Fund	249,787	207,797
Coast Trading Trust Fund	0	182,356
Airport Loans Special Revenue Fund	1,266,300	143,868
Historical Society Donations Fund	0	100,746
Moderate Rehabilitation Operating Reserve Fund	37,389	87,768
Agriculture-Commercial Fertilizer Fund	117,679	76,475
Foster Children Fund	33,477	33,477
Water & Waste Water Operators' Fund	22,205	28,262
Agriculture-Commercial Feed ERA Fund	24,551	24,551
Eugene W. Price Scholarship Fund	13,186	13,186

MEDB Bond Guarantee Fund	0	6,726
Lease Participation Certificates Fund	86,595	0
Joseph Homan Fellowship Fund	1,809	0
TOTAL	\$ 76,156,799	\$ 107,318,867

Other Retirement Funds:	1983-1984	1984-1985
Statewide Police Reserve Fund	\$ 13,727,875	\$ 16,206,715
Sheriffs' Retirement Fund	12,490,551	15,309,413
Firefighters' Unified Retirement Fund	11,377,786	14,231,372
Highway Patrol Retirement Fund	10,805,118	12,468,353
Montana Judges' Retirement Fund	5,288,407	6,280,921
Game Wardens' Retirement Fund	4,908,043	5,755,842
Volunteer Firemens' Fund	3,329,822	3,799,943
TOTAL	\$ 61,927,602	\$ 74,052,559

Long Range Building Funds:	1983-1984	1984-1985
Long Range Building Bonded Program Fund	\$ 32,093,865	\$ 21,593,917
Long Range Building Fund	7,416,689	6,253,281
Capitol Renovation Fund	6,221,191	5,449,882
1983 Fish Wildlife & Parks Program Fund	2,956,374	1,349,304
Workers' Compensation Building Fund	1,109,174	1,109,174
Job Service Building Fund	384,919	197,503
Series 1981 Fund	4,487,689	146,364
Everett Lynn Trust Fund	0	93,387
TOTAL	\$ 54,669,901	\$ 36,192,812

Various University Funds:	1983-1984	1984-1985
Montana State University	\$ 5,008,722	\$ 4,758,017
University of Montana	7,166,338	4,741,806
Eastern Montana College	1,694,681	1,045,995
Montana Tech	2,220,993	583,333
Northern Montana College	296,951	477,775
Western Montana College	44,272	130,679
TOTAL	\$ 16,431,957	\$ 11,737,605

Other STIP* Funds:	1983-1984	1984-1985
County Funds	\$ 4,425,102	\$ 8,388,584
City Funds	593,495	566,100
Police Funds	67,564	69,800
Fire Department Relief Associations	27,271	26,100
School Funds	9,157	4,800
TOTAL	\$ 5,122,589	\$ 9,055,384

*County and city funds not under the control of the State of Montana.

SCHEDULE B
INVESTMENT INCOME 1984-85 FISCAL YEAR

FUND	CASH	CURRENT AMORTI- ZATION	NET DEFERRED GAIN OR (LOSS)	STIP INCOME	MONT-COMP INCOME	MODIFIED INCOME	ACCRUED INCOME	NET INCOME
Public Employees' Retirement System Fund	\$ 42,153,721	\$ 1,204,719	\$ (1,332,103)	\$ 0	\$ 4,400,624	\$ 46,426,961	\$ 976,655	\$ 47,403,616
Teachers' Retirement System Fund	31,488,172	996,141	(1,111,612)	0	3,865,355	35,238,056	798,598	36,036,654
Permanent Coal Trust Fund	24,986,982	316,148	7,168	1,631,205	0	26,941,503	746,536	27,688,039
Treasurer's Fund	13,233,926	0	0	12,300,538	0	25,534,464	(614,439)	24,920,025
Trust & Legacy Fund	19,165,172	1,017,508	(907,564)	0	0	19,275,116	83,356	19,358,472
Educational Trust Fund	7,722,869	111,709	(27,670)	310,279	0	8,117,187	242,655	8,359,842
Workers' Compensation Fund	7,486,187	432,001	(517,007)	0	0	7,401,181	(310,460)	7,090,721
Resource Indemnity Fund	5,291,312	121,485	(43,917)	158,367	0	5,527,247	(17,355)	5,509,892
Highway Revenue Bond Construction Fund	2,544,410	104,905	0	850,907	0	3,500,222	(292,998)	3,207,224
Highway Revenue Bond Proceeds Fund	3,419,279	44,693	0	230,992	0	3,694,964	(570,641)	3,124,323
Long Range Building Bonded Program Fund	2,622,296	25,015	0	466,003	0	3,113,314	(56,578)	3,056,736
Common School Interest & Income Fund	2,442,259	18,967	0	344,873	0	2,806,099	138,825	2,944,924
Statewide Police Reserve Fund	1,570,778	31,919	(15,904)	150,397	50,253	1,787,443	87,460	1,874,903
Sheriffs' Retirement Fund	1,441,259	25,585	(12,047)	96,816	72,099	1,623,712	64,542	1,688,254
Coal Tax-Park Acquisition Fund	1,245,516	26,073	(478)	209,593	0	1,480,704	147,558	1,628,262
Firefighters' Unified Retirement Fund	1,229,408	16,989	6,219	252,195	26,968	1,531,779	84,670	1,616,449
Montana Instate Investments Fund	0	0	0	1,384,694	0	1,384,694	39,664	1,424,358
Highway Revenue Bond Debt Service Fund	1,232,262	44,968	0	44,561	0	1,321,791	(3,992)	1,317,799
Highway Patrol Retirement Fund	1,125,892	29,440	(20,304)	42,913	69,082	1,247,023	29,815	1,276,838
Group Benefits Fund	567,160	17,435	0	770,007	0	1,354,602	(91,548)	1,263,054
Agency Insurance Fund	755,835	4,328	0	160,889	0	921,052	108,861	1,029,913
Capitol Renovation Fund	136,093	291	0	141,965	0	278,349	429,327	707,676
Montana State University	38,517	0	0	655,215	0	693,732	(7,361)	686,371
Long Range Building Fund	185,971	0	0	490,795	0	676,766	(19,699)	657,067
Montana Judges' Retirement Fund	535,796	10,238	(4,926)	28,143	42,629	611,880	24,429	636,309
1984 Series A Bond Proceeds Fund	384,734	0	0	211,341	0	596,075	39,696	635,771
Local Impact Fund	0	0	0	600,749	0	600,749	(11,052)	589,697
Game Wardens' Retirement Fund	505,670	15,076	(17,199)	26,653	32,243	562,443	22,807	585,250
University of Montana	0	0	0	606,453	0	606,453	(29,450)	577,003
Social Security Fund	507,477	688	0	0	0	508,165	15,175	523,340
Volunteer Firemens' Fund	362,662	15,379	(6,479)	35,800	0	407,362	14,396	421,758
Hail Insurance Fund	40,666	40	0	325,662	0	366,368	(4,424)	361,944
BN Geraldine Settlement Fund	184,405	0	0	104,890	0	289,295	16,926	306,221
Rail Construction Fund	198,237	0	0	75,445	0	273,682	22,457	296,139
Other STIP Funds	0	0	0	332,032	0	332,032	(38,699)	293,333
Series 1981 Fund	421,215	0	0	236,078	0	657,293	(375,485)	281,808
Subsequent Injury Fund	253,484	16,554	(11,589)	18,326	0	276,775	(2,610)	274,165
BN Geraldine Connector Fund	176,506	2,441	0	3,110	0	182,057	90,078	272,135
Highway Revenue Capitalized Interest Fund	349,680	9,600	0	43,511	0	402,791	(136,342)	266,449
1983 Fish, Wildlife & Parks Bonded Program Fund	195,439	1,234	0	66,106	0	262,779	(2,187)	260,592
Guaranteed Student Loan Fund	0	0	0	236,356	0	236,356	5,745	242,101
Livestock Commission-Animal Health ERA Fund	0	0	0	149,585	0	149,585	(4,904)	144,681
Montana Tech	14	151	0	159,593	0	159,758	(15,893)	143,865
Debt Service Reserve Fund	64,739	2,221	0	242	0	67,202	63,858	131,060
DNRC Water Development Fund	87,321	791	0	36,819	0	124,931	(4,873)	120,058

FUND	CASH	CURRENT AMORTI- ZATION	NET DEFERRED GAIN OR (LOSS)	STIP INCOME	MONT-COMP INCOME	MODIFIED INCOME	ACCRUED INCOME	NET INCOME
Workers' Compensation Building Fund	0	0	0	121,015	0	121,015	(2,006)	119,009
Lands & Resource Development Fund	0	0	0	104,235	0	104,235	(2,466)	101,769
Eastern Montana College	96,979	0	0	0	0	96,979	(515)	96,464
Group Insurance Fund	0	0	0	82,551	0	82,551	10,958	93,509
Airport Loans Special Revenue Fund	131,807	0	0	0	0	131,807	(47,541)	84,266
Northern Montana College	0	0	0	83,142	0	83,142	(702)	82,440
Woodville Highway Replacement Fund	0	0	0	83,375	0	83,375	(1,819)	81,556
Crime Victims' Compensation Fund	57,054	705	0	19,713	0	77,472	1,861	79,333
Wheat Research & Marketing Fund	0	0	0	66,775	0	66,775	(5,280)	61,495
Uninsured Employers Fund	18,436	52	0	34,317	0	52,805	868	53,673
Board of Oil & Gas Fund	0	0	0	54,194	0	54,194	(558)	53,636
Section 155 Grant Fund	0	0	0	52,689	0	52,689	(148)	52,541
Real Property Trust Fund	47,857	0	0	0	0	47,857	2,158	50,015
Highway Building Complex Sinking Fund	56,187	56	0	0	0	56,243	(7,749)	48,494
Livestock Commission-Inspection & Control Fund	0	0	0	44,672	0	44,672	(740)	43,932
Job Service Building Fund	0	0	0	41,268	0	41,268	(2,194)	39,074
Operating Reserve Fund	0	0	0	35,809	0	35,809	842	36,651
Montana Rural Rehabilitation Fund	0	0	0	35,730	0	35,730	246	35,976
Livestock Commission-Animal Health Emergency Fund	0	0	0	36,480	0	36,480	(802)	35,678
Flood Insurance Fund	0	0	0	34,169	0	34,169	(280)	33,889
Warner Amendment Fund	0	0	0	30,623	0	30,623	(1,062)	29,561
Lease Participation Certificates Fund	24,964	0	0	0	0	24,964	(341)	24,623
William Murphy Fund	1,171	0	0	1,857	20,636	23,664	(33)	23,631
Housing Authority Fund	19,243	0	0	0	0	19,243	0	19,243
1984 Series A Debt Service Fund	0	0	0	18,043	0	18,043	0	18,043
Western Montana College	0	0	0	16,635	0	16,635	542	17,177
Agriculture-Commercial Fertilizer Fund	0	0	0	11,572	0	11,572	(505)	11,067
Everett Lynn Trust Fund	2,453	54	0	406	0	2,913	4,599	7,512
Moderate Rehabilitation Operating Reserve Fund	0	0	0	5,171	0	5,171	313	5,484
Coast Trading Trust Fund	3,658	0	0	0	0	3,658	1,738	5,396
Potter Trust Fund	(12)	0	0	2,045	3,144	5,177	11	5,188
TRS-Minnie Fullam Fund	(8)	0	0	3,296	1,612	4,900	(26)	4,874
Historical Society Donations Fund	5	0	0	0	0	5	4,664	4,669
Bradley Trust Fund	0	0	0	0	3,869	3,869	0	3,869
Dixon Endowment Fund	3,820	0	0	0	0	3,820	0	3,820
Teakle Trust Fund	0	0	0	0	3,547	3,547	0	3,547
Foster Children Fund	0	0	0	3,226	0	3,226	(53)	3,173
Agriculture-Commerical Feed ERA Fund	0	0	0	2,542	0	2,542	(42)	2,500
Water & Waste Water Operators' Fund	0	0	0	2,324	0	2,324	18	2,342
Charles Bair Trust Fund	92	0	0	0	0	92	1,853	1,945
General Trust Fund	0	0	0	0	1,290	1,290	0	1,290
Eugene W. Price Scholarship Fund	0	0	0	1,271	0	1,271	(21)	1,250
Merritt-Wheeler Memorial Fund	0	0	0	0	725	725	0	725
Joseph Homan Fellowship Fund	0	0	0	320	0	320	(17)	303
MEDB Bond Guarantee Fund	0	0	0	113	0	113	50	163
Caras Endowed Scholarship Fund	0	0	0	0	81	81	0	81
TOTAL	\$ 176,817,027	\$ 4,665,599	\$ (4,015,412)	\$ 25,019,676	\$ 8,594,157	\$ 211,081,047	\$ 1,638,920	\$ 212,719,967

**SCHEDULE C
SUMMARY OF BOND SWAPS
FOR FISCAL YEAR 1984-85**

FUND:	PAR SOLD	PAR ACQUIRED	REALIZED GAIN or (LOSS)	DEFERRED GAIN or (LOSS)
Public Employees' Retirement System Fund	\$ 54,171,975	\$ 54,171,975	\$ (1,247,927)	\$ (72,285)
Trust & Legacy Fund	42,369,237	42,369,237	(1,409,023)	(149,677)
Teachers' Retirement System Fund	38,545,123	38,545,123	(605,268)	(82,278)
Permanent Coal Trust Fund	22,309,304	22,309,304	1,294,397	14,818
Workers' Compensation Fund	13,195,000	13,195,000	(834,659)	(41,762)
Educational Trust Fund	7,400,000	7,400,000	710,973	9,023
Resource Indemnity Fund	3,260,000	3,260,000	66,431	(3,320)
Statewide Police Reserve Fund	2,200,000	2,200,000	(121,005)	(5,386)
Firefighters' Unified Retirement System Fund	1,600,000	1,600,000	144,657	2,908
Sheriffs' Retirement Fund	1,200,000	1,200,000	31,062	(450)
Highway Patrol Retirement Fund	420,000	420,000	(37,335)	(305)
Montana Judges' Retirement Fund	410,000	410,000	(7,351)	(510)
Game Wardens' Retirement Fund	365,000	365,000	(25,236)	(252)
Volunteer Firemens' Fund	300,000	300,000	5,061	89
Subsequent Injury Fund	300,000	300,000	16,394	217
Coal Tax Park Acquisition Fund	200,000	200,000	4,916	75
TOTAL	\$ 188,245,639	\$ 188,245,639	\$ (2,013,913)(1)	\$ (329,095)(2)

(1) If the completed transaction method was used for gains and losses on bond swaps.

(2) Based on the deferral method of accounting for gains and losses on bond swaps.

**SCHEDULE D
TYPE OF INVESTMENTS**

OTHER:	1983-1984	1984-1985
Statewide Police Reserve Fund:		
City of Havre City Hall Bonds	\$ 50,000	\$ 50,000
Public Employees' Retirement System Fund:		
ESC Building Revenue Bond	324,030	228,972
Building and Land	135,966	130,655
Teachers' Retirement System Fund:		
Building and Land	138,578	136,762
SRS Building	1,321,117	1,260,486
TOTAL	\$ 1,969,691	\$ 1,806,875

**SCHEDULE E
UNAMORTIZED DEFERRED
GAINS or (LOSSES) ON BOND SWAPS
As of June 30, 1985**

FUND:	BALANCE
Public Employees' Retirement System Fund	\$ (15,875,195)
Teachers' Retirement System Fund	(10,571,385)
Trust & Legacy Fund	(9,194,442)
Workers' Compensation Fund	(6,703,171)
Resource Indemnity Fund	(464,294)
Highway Patrol Retirement Fund	(347,412)
Statewide Police Reserve Fund	(275,579)
Game Wardens' Retirement Fund	(196,978)
Sheriffs' Retirement Fund	(188,519)
Educational Trust Fund	(122,058)
Subsequent Injury Fund	(113,420)
Montana Judges' Retirement Fund	(75,756)
Volunteer Firemens' Fund	(51,827)
Coal Tax Park Acquisition Fund	(9,003)
Firefighters Unified Retirement Fund	202,829
Permanent Coal Trust Fund	1,293,141
TOTAL	\$ (42,693,069)

STATE OF MONTANA BOARD OF INVESTMENTS GENERAL FOOTNOTES

Income Yield

The yields for the Treasurer's Fund and STIP are calculated by determining the daily average invested balances and dividing this into net income for the fiscal year. All other portfolio yields are calculated as follows: two times net income divided by the beginning and ending asset balances less net income.

INVESTMENT INCOME YIELD SUMMARY FISCAL YEAR 1985

All Funds	12.80%
Treasurer's Fund	9.58%
Short-Term Investment Pool	10.10%
Short-Term Investment Pool II	7.64%
Public Employees' Retirement System Fund	11.59%
Teachers' Retirement System Fund	11.40%
Trust & Legacy Fund	12.27%
Workers' Compensation Fund	12.56%
Highway Patrol Retirement Fund	11.61%
Montana Judges' Retirement Fund	11.64%
Game Wardens' Retirement Fund	11.61%
Sheriffs' Retirement Fund	12.93%
Statewide Police Reserve Fund	13.36%
Resource Indemnity Fund	13.16%
Educational Trust Fund	13.78%
Permanent Coal Trust Fund	13.99%

Total Investments

The total Short-Term Investment Pools and the Montana Common Stock Pool investments as included in the Type of Investments differs from their investments included in the Source of Investments by the net amount of \$2,806,223. The difference is because the Type of Investments shows the original cost of the investments owned by the pools while the Source of Investments shows the participants cost of units purchased within the pools.

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